

# GENDER DIFFERENCES IN THE MANAGEMENT OF INDIVIDUAL RETIREMENT ACCOUNTS

Robert L. Clark  
Professor  
College of Management  
North Carolina State University

---

## INTRODUCTION

The well known financial problem facing Social Security in the twenty-first century requires the immediate attention of Congress. In order to restore the financial integrity of this very important retirement program, Congress and the Administration are now considering a series of options to reform Social Security ranging from modifying the current system to the adoption of mandatory individual accounts as a major source of retirement benefits.

My testimony today examines the economic effects on women of eliminating the present Social Security benefit structure and replacing it with system of mandatory individual retirement accounts. My presentation focuses on three areas of emphasis identified in Chairman Grassley and Senator Breaux's letter of invitation to me. First, I will discuss the findings of my research concerning gender differences in the management of 401 (k) plans. Second, I will extend these results to examine how women might fare under a Social Security system dominated by individual retirement accounts as well as examining other potential problems for women associated with shifting to individual accounts. Third, I will identify possible restrictions on the management of these accounts that could moderate or eliminate potential adverse effects of individual accounts on women.

## GENDER DIFFERENCES IN 401(k) PLANS

Understanding the financial decisions of men and women currently covered by 401 (k) plans provides the best evidence of how workers might be affected by the adoption of mandatory individual retirement accounts as part of a new Social Security system. Recently, some analysts have speculated that women, in comparison to men, are less likely to participate in 401 (k) plans, contribute a smaller share of their earnings to their retirement plans, and invest their pension funds more conservatively yielding a lower retirement benefit. These hypotheses have received considerable public attention; however, they have not been verified by broad-based research studies. Despite the lack of evidence, these assertions have made their way into the policy debates concerning the adoption of mandatory individual retirement accounts as a component of Social Security. To test the validity of these assertions, Gordon Goodfellow, Sylvester Schieber, Drew Warwick, all of Watson Wyatt Worldwide, and I examined the employment records of 87 companies with 401(k) plans. Using these data, we were able to examine gender differences in the participation rate in 401(k) plans along with the proportion of annual earnings that workers contributed to their plan in 1995. In addition, we examined the allocation of 1995 contributions and plan assets between fixed income assets equities. The results of this study are highlighted in Figures 1-7 and Tables 1-4. While the research findings presented in the first part of my testimony are the result of joint work with Goodfellow, Schieber, and Warwick, the conclusions expressed in the second part of the testimony are my own and should not be attributed to my research colleagues.

The relationships shown in the figures are based on a statistical analysis of approximately 150,000 workers in the 87 companies. Female employees represented 46 percent of the sample. The women tended to be somewhat younger than the male workers and on average, had lower earnings. The following conclusions are based on statistical estimates of the probability that worker participated in a

401 (k) plan and given participation, the proportion of salary allocated to the plan during 1995. Finally, I report findings on how contributions to the 401 (k) plans along with account balances were invested. The statistical analysis shows how the decisions of men and women of the same age, tenure, and earnings differ in their decisions concerning retirement savings. Tables 1-4 report mean values of the various relationships by gender, age, and annual earnings while Figures 1-7 are based on statistical estimates that hold constant the worker's age, earnings, job tenure, and the employer.

Key findings of this analysis are:

Are women less likely to make contributions to 401(k) plans and do they make smaller annual contributions to these plans? No, research findings indicate the women of similar age, job tenure, and earnings are actually more likely to participate in voluntary 401(k) plans and they tend to- contribute a larger percentage of their annual earnings.

- Almost 80 percent of all workers in these firms made a contribution to the 401 (k) plan in 1995. The proportion of workers who made a contribution to the 401 (k) plan in 1995 increased with age and with annual earnings up to \$75,000.
- Women of the same age, tenure, and earnings in these firms were actually more likely to have participated in the 401(k) plan in 1995 than men (Figures 1 and 2). In total 80 percent of the women and 78 percent of the men made a 1995 contribution to their 401(k) plan.
- Given participation, the typical worker, both male and female, contributed about 7 percent of their 1995 earnings to the 401 (k) plan). Standardizing for age, job tenure, and earnings, women contributed a higher proportion of annual earnings to the 401 (k) plan than men and the difference increased with annual earnings.

Are women more conservative investors than men with their 401(k) contributions and account balances in plans that do not offer or require investment in company stock? No, in these plans, women tend to hold approximately the same percent of their retirement funds in fixed income assets as do men.

- In plans with no company stock requirements, the proportion of contributions and asset balances allocated to equities by both men and women declines with age reflecting the expected lifecycle pattern of saving decisions.
- In plans with no company stock requirements, the proportion of contributions and asset balances allocated to equities by both men and women increases with annual earnings.
- In plans with no company stock requirements, men and women invested approximately the same proportion of their 1995 contributions to fixed income assets.

Are women more conservative investors in 401(k) plans that offer or require an investment in company stock? Yes, in these plans, men tend to hold a larger proportion of their retirement funds in company stock than do women while women hold a larger proportion in fixed income assets.

- In companies that provided company stock as an investment option, women allocated a higher proportion of their contributions and account balances to fixed income assets than men.
- In these companies, men invested a higher proportion of contributions and account balances to company stock than women at all levels of earnings.

On the basis of these findings, I reject the hypothesis that women are less concerned about saving for their retirement. Instead, the data show that women of comparable age and earnings are somewhat more likely to contribute to their 401 (k) plans and contribute a higher percent of annual earnings if they do decide to make a contribution. Also rejected is the hypothesis that women are less able or more conservative investors. The evidence shows that in general, women and men make similar investment decisions with their retirement funds except when the plans include company stock as a part of the investment options. Men do tend to be more willing to accept the greater risk associated with investing in the stock of their employers than are women.

Several caveats should be attached to these conclusions. First these results are based on an analysis of working women who already are covered by a 401 (k) plan and have some experience with these investment options. Second, the analysis compares women to men with comparable job tenure and earnings. In general, this comparison will mean that the overall household income for women is higher than that for men and this may lead to the finding of increased retirement saving and a willingness of women to bear more risk men with the same earnings. Third, as a group, women have fewer years of job tenure and lower earnings than men. Thus, differences in retirement savings may occur if one compares all women to all men without considering employment characteristics. However, I would reiterate that on the basis of available evidence, we must conclude that there is relatively little difference in the behavior of men and women with similar work characteristics in their approach to managing their individual accounts in 401 (k) plans.

### **INDIVIDUAL RETIREMENT ACCOUNTS AND THEIR IMPACT ON WOMEN**

Replacing the current Social Security benefit structure with mandatory individual retirement accounts would mean that future Social Security retirement benefits for each person would depend more directly on the amount contributed into their individual accounts. The realized benefit in retirement will depend on contributions while working, investment decisions by the worker, and distribution choices. Potential gender differences in the shift to individual accounts are possible in each of these areas. First, in a pure individual account plan, all contributions of each person would be credited to their own account. There would be no subsidy to the individuals and no tax on these funds to redistribute to others in the manner that the current Social Security system does. Thus, men and women of comparable earnings and years of work would make the same contributions into their own account.

The evidence presented above indicates that, in general, men and women with comparable job tenure and earnings make similar investment choices. If they have the same investment results, they would have the same total in their fund at retirement. However, on average, women have lower incomes and fewer years of service. Under the present Social Security system, women receive a greater share of the subsidy associated with the progressive benefit formula. Under a pure individual accounts plan they would not receive the same subsidy.

This potential adverse effect on women from a shift to individual accounts could be moderated (or eliminated) by the use of subsidies to the contributions of low income workers from either the general fund as the President has proposed for his voluntary individual accounts plan or by a tax on the contributions of higher income workers. Such plans would benefit all low income workers relative to high income workers and would not simply provide additional benefits to all women.

The evidence presented above indicates that women are at least as likely as men to make voluntary contributions to their retirement accounts and tend to contribute at least as high a percent of their salary

to these accounts. Virtually all proposals for the shift to individual accounts would require mandatory contributions so that potential gender differences in participation and contributions need not be examined further in regard to evaluating these plans. However, some proposals for maintaining the basic benefit structure of the current system would permit voluntary additional contributions to individual accounts or voluntary contributions on top of a mandatory component. My research would indicate women would be equally as likely as men to take advantage of these voluntary retirement plans.

Given similar contributions, will investment decisions by women lead to smaller funds at retirement? Again, the evidence indicates that gender differences in investment patterns should not be a cause of concern. The key point concerning investment patterns in a system of mandatory individual accounts is the range of investment options permitted to all participants. Congress could allow unrestricted choice of investments or could limit investments to few basic options. Policies could be adopted that would mandate some minimum allocation of assets to both fixed income and equities. For example, each investor could be required to devote a minimum of 25 percent of their account balance to fixed income assets and 25 percent to equities with the remainder being invested at the participant's discretion and these minimum investment limits could change with the age of the worker. My research indicates that the decision on whether such restrictions should be placed on Social Security participants need not be based on gender differences in risk aversion or investment ability.

Converting individual accounts into retirement income can be done through lump sum distributions or through converting the funds into a life annuity. At present, Social Security benefits provide a life annuity to both the retired worker and his/her spouse. The benefit formula is gender neutral so that men and women with comparable earnings receive comparable annual benefits. However, women have a longer life expectancy than men so that the current system provides an implicit subsidy to women in the form of a greater present value of lifetime benefits. At age 65, life expectancy for women is almost 20 years while that of men is just over 16 years.

Converting the individual accounts of the future into life annuities raises several issues. First, if left to the private market that considers gender in the determination of life expectancy, similar individual retirement accounts would yield smaller annual benefits for women. This issue could be dealt with by requiring annuitization and having the government provide gender neutral annuities. Second, since wives tend to outlive their husbands, consideration must be given to whether an individual accounts plan will provide adequate protection for widows. Currently, Social Security provides a widow's benefit equal to the retired worker's benefit. Similar protection could be provided under an individual accounts plan by requiring that retirement funds be converted to joint life annuities. In such a case, family income would be unaffected by the death of the retired worker. Currently, household Social Security benefits decline by one-third when the retired worker dies.

The current system provides two other types of benefits that provide disproportionate benefits to women. These are the spouse benefit and the benefit to divorced spouses. While gender neutral in principle, virtually all of these benefits are paid to women.

Currently, a married woman who had never made contributions into Social Security can receive a benefit equal to 50 percent of her husband's benefit. Obviously, this benefit subsidizes certain types of households and this subsidy would be eliminated in most proposals for individual accounts.

For divorced women, Social Security currently provides a spouse benefit if the marriage lasted at least 10 years. This benefit structure provides some basic retirement income protection for divorced women and an implicit subsidy to men who have multiple wives. With individual accounts, there is a measurable retirement fund that could be considered as part of household wealth in divorce settlements. Thus, the retirement benefits generated by a worker's contribution could be allocated to himself, current

spouse, and all past spouses. The distribution of these funds could be specified by law or could be left to the judicial process. An alternative would be to adopt a system of earnings sharing within the household so that half of all family earnings are deposited into the individual account of the husband and half to the wife's account.

### **GENDER CONSIDERATIONS IN DECIDING WHETHER TO ADOPT INDIVIDUAL RETIREMENT ACCOUNTS**

In summary, my testimony has two major conclusions:

1. Women should not be considered unable or unwilling to save for retirement. Nor should they be considered less sophisticated investors. My research shows that the investment decisions of women in 401 (k) plans are similar to those of men with similar work histories. As such, shifting Social Security to a system of individual accounts should not be rejected because of concerns about the quality of women's investment decisions.
2. In making the decision whether to adopt mandatory individual accounts as a central component of Social Security in the twenty-first century, Congress must consider how such a fundamental change in social policy will affect various economic and demographic groups. It is important to recognize that most gender associated with individual retirement accounts can be addressed by restrictions or requirements concerning distributions, subsidies, and investment options. If mandatory individual accounts are adopted, Congress must decide whether the advantages of such restrictions outweigh the distortions that they may introduce into the new system of retirement income provisions.